TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Uniform Issue List
419.00-00
419A.00-00
511.00-00
512.00-00

Contact Person:

Identification Number:

Telephone Number:

Taxpayer Identification Number:

Legend:

Taxpayer =

Company X =

Company Y =

Plan A =

Plan B =

Group Polic =

Insurance
Company =

Dear :

This responds to your letter, dated December 30, 2011, requesting a ruling as to the federal tax consequences of a proposed transaction under section 511 of the Internal Revenue Code (Code).

FACTS

Taxpayer is a voluntary employees' beneficiary association (VEBA) under section 501(c)(9) of the Code. Taxpayer represents that it is a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5). Taxpayer provides health

benefits for retired employees of Company X and Company Y who are covered under Plan A.

Company Y is the current policyholder of Group Policy with Insurance Company, which provides basic term life insurance benefits to retired employees who are covered by Plan B. Taxpayer represents that benefits under Plan A and Plan B were negotiated by Company Y and its predecessors and are provided under a series of collective bargaining agreements that were in effect when the covered individuals retired.

Group Policy establishes a "retirement funding account" ("RFA") that is a retired lives reserve. Taxpayer represents that the RFA is a welfare benefit fund under section 419(e). The proposed transaction is the transfer of all or a portion of the RFA assets allocated to Plan B from Group Policy to Taxpayer, where the assets will be used to provide retiree health benefits under Plan A. Taxpayer represents that it would take approximately one year to exhaust the transferred assets by paying retiree medical and dental benefits under Plan A.

RULING REQUESTED

You requested a ruling that the income generated by the transferred RFA assets held in Taxpayer will not be subject to unrelated business income tax under section 511 of the Code.

LAW

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund are not deductible under Chapter 1, but if they would otherwise be deductible, are (subject to the limitation of section 419(b)) deductible under section 419 for the taxable year in which paid.

Section 419(b) limits the employer's deduction under section 419(a) to a welfare benefit fund's qualified cost for the taxable year.

Section 419(c)(1) defines the qualified cost of a welfare benefit fund for a taxable year as the sum of the qualified direct cost for the taxable year and, subject to the limitation of section 419A(b), any addition to a qualified asset account for the taxable year.

Section 419(c)(2) provides that the qualified cost for any taxable year is reduced by the welfare benefit fund's after-tax income for the taxable year.

Section 419(e)(1) defines the term "welfare benefit fund" to include any fund through which the employer provides welfare benefits to employees or their beneficiaries.

Section 419(e)(3) defines the term "fund" to include an organization described in section 501(c)(9), and also, to the extent provided in regulations, any account held for an employer by any person.

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Section 419A(a) defines the term "qualified asset account" to include any account consisting of assets set aside to provide for the payment of medical or life insurance benefits.

Section 419A(b) provides that no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent such addition results in the amount of such account exceeding the account limit.

Section 419A(f)(5)(A) provides that no account limits shall apply in the case of a qualified asset account under a separate welfare benefit fund under a collective bargaining agreement.

Treas. Reg. § 1.419-1T, Q&A-2(a), provides that section 419 generally applies to contributions paid or accrued with respect to a welfare benefit fund after December 31, 1985, in taxable years of employers ending after that date.

Treas. Reg. § 1.419-2T, Q&A-1, provides that neither contributions to nor reserves of a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) The date upon which the last of the collective bargaining agreements relating to the fund in effect on the date of issuance of final regulations concerning such limits terminates, or (ii) the date three years after the issuance of final regulations.

Treas. Reg. § 1.419A-2T, Q&A-2, states:

> (1) For purposes of Q&A-1, a collectively bargained welfare benefit fund is a welfare benefit fund that is maintained pursuant to an agreement which the Secretary of Labor determines to be a collective bargaining agreement and which meets the requirements of the Secretary of the Treasury as set forth in paragraph (2) below.
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> (2) Notwithstanding a determination by the Secretary of Labor that an agreement is a collective bargaining agreement, a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arms-length negotiations between the employee representatives and one or more employers, and if such agreement between employee representatives and one or more employers satisfies Code section 7701(a)(46). Moreover, the circumstances surrounding a collective bargaining agreement must evidence good faith bargaining between adverse parties over the welfare benefits to be provided through the fund. Finally, a welfare benefit fund is not considered to be maintained pursuant to a collective bargaining agreement unless at least 50 percent of the employees eligible to receive benefits under the fund are covered by the collective bargaining agreement.
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> (3) In the case of a collectively bargained welfare benefit fund, only the portion of the fund (as determined under allocation rules to be provided by the Commissioner) attributable to employees covered by a collective bargaining agreement, and from which benefits for such employees are provided, is considered to be maintained pursuant to a collective bargaining agreement.

> (4) Notwithstanding the preceding paragraphs and pending the issuance of regulations setting account limits for collectively bargained welfare funds, a welfare benefit fund will not be treated as a collectively bargained welfare benefit fund for purposes of Q&A-1 if and when, after July 1, 1985, the number of employees who are not covered by a collective bargaining agreement and are eligible to receive benefits under the fund increases by reason of an amendment, merger, or other action of the employer or the fund. In addition, pending the issuance of such regulations, for purposes of applying the 50 percent test of paragraph (2) to a welfare benefit fund that is not in existence on July 1, 1985, "90-percent" shall be substituted for "50-percent."

Section 501(c)(9) provides for the exemption from federal income tax of voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 511 imposes a tax on the unrelated business taxable income of organizations described in section 501(c)(9).

Section 512(a)(3)(A) provides that, in the case of an organization described in section 501(c)(9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by Chapter 1 which are directly connected with the production of the gross income (excluding exempt function income), both computed with modifications.

Section 512(a)(3)(B)(ii) provides that, in the case of an organization described in section 501(c)(9), "exempt function income" includes all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to section 512(a)(1)), which is set-aside to provide for the payment of life, sick, accident, or other benefits, including reasonable costs of administration directly connected with its exempt purpose.

Section 512(a)(3)(E)(i) provides that in general, in the case of an organization described in section 501(c)(9), a set-aside for any purpose specified in section 512(a)(3)(B)(ii) may be taken into account under subparagraph (B) only to the extent that it does not result in an amount of assets set aside for such purpose in excess of the account limit determined under section 419A (without regard to subsection (f)(6) thereof) for the taxable year (not taking into account any reserve described in section 419A(c)(2)(A) for post-retirement medical benefits).

ANALYSIS AND CONCLUSION

Section 511 imposes income tax on the unrelated business taxable income (UBTI) of certain tax-exempt organizations, including VEBAs. Under section 512(a)(3)(A), the UBTI of a VEBA is the VEBA's gross income (excluding exempt function income), less certain specified deductions, both computed with certain specified modifications.

Under section 512(a)(3)(B)(ii), in the case of VEBAs, exempt function income generally means all income set aside to provide for the payment of life, sick, accident, or other benefits, including certain specified reasonable costs of administration. However, section 512(a)(3)(E)(i) places limitations on the amount in a set-aside that may treated as exempt function income.

Under these limitations, a set-aside for any purpose specified in section 512(a)(3)(B)(ii) may be taken into account as exempt function income only to the extent that it does not result in an amount of assets that exceeds the account limit determined under section 419A (without regard to subsection (f)(6) thereof) for the taxable year (not taking into account any reserve described in section 419A(c)(2)(A) for post-retirement medical benefits).

However, funds maintained pursuant to collective bargaining agreements come within the special rule for collectively bargained plans under section 419A(f)(5). Pending the adoption of final regulations to implement section 419A(f)(5), § 1.419A-2T, Q&A 1, provides that amounts held in welfare benefit funds that are maintained pursuant to a collective bargaining agreement will not be treated as exceeding the otherwise applicable limits of sections 419(b), 419A(b), or 512(a)(3)(E). After the publication of these temporary regulations, section 419A(f)(5) was amended in the Tax Reform Act of 1986, retroactive to the effective date of the Tax Reform Act of 1984, to provide that no account limits shall apply in the case of a qualified asset account under a separate welfare benefit fund under a collective bargaining agreement.

While the Service has not issued final regulations to clarify the precise scope of section 419A(f)(5), as amended in 1986, we conclude that pending the adoption of final regulations, and based upon Taxpayer's representation that Taxpayer is a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5)(A), the assets held by Taxpayer are not subject to account limits imposed by section 419A for purposes of determining unrelated business income under section 512(a)(3). Accordingly, the income generated by the transferred RFA assets held by Taxpayer will not be subject to the tax on unrelated business income under section 511.1

This ruling will be made available for public inspection under Code section 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Code section 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections

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1 This ruling only addresses UBTI on amounts that, but for the application of section 419A(f)(5) and the regulations thereunder, would be subject to the limits of section 512(a)(3)(E). Specifically, Taxpayer would be subject to UBTI on gross income derived from any unrelated trade or business (as defined in section 513) regularly carried on by Taxpayer, computed as if Taxpayer were subject to section 512(a)(1).

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described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Michael Seto
Manager, EO Technical

Enclosure
Notice 437

cc: